STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6956

Tariff filing of Citizens Communications Company,
d/b/a Citizens Energy Services, requesting a rate
increase in the amount of 40.02%, to take effect
December 15, 2001

PREFILED TESTIMONY OF
WILLIAM STEINHURST
ON BEHALF OF THE
VERMONT DEPARTMENT OF PUBLIC SERVICE

March 7, 2002

Summary: The purpose of Dr. Steinhurst's testimony is to review the conclusions of the Department's witnesses on the Hydro Quebec Contract, to explain the Department's position regarding that Contract, and to recommend the adjustment relating to that Contract that should be used in setting rates for the Company.

Prefiled Testimony of William Steinhurst

Q. Please state your name and occupation.

A. My name is William Steinhurst, and I am the Director for Regulated Utility Planning for the Vermont Department of Public Service ("Department", "DPS"). My business address is 112 State Street, Montpelier, Vermont.

Q. Please summarize your relevant educational and work experience.

A. I have a B.A. in Physics, an M.A. in Statistics, and a Ph.D. in Mechanical Engineering. I have served as a planner and planning manager for the Vermont Agency of Human Services and the Departments of Corrections, Social and Rehabilitative Services, and Public Service. While at the DPS, I have prepared or supervised preparation of numerous long range plans and policy studies and have testified as an expert witness on a variety of rate making and planning issues before the Public Service Board. My resume is available on request.

Q. What is the purpose of your testimony?

A. I will review the testimony and recommendations of the Department's witnesses on certain matters regarding the Hydro Quebec-Vermont Joint Owner's power purchase contract ("HQ contract," "the Contract"). I also provide the Department's recommendation for rate treatment of the Contract and explain why the Board should follow that recommendation.

Q. What are the Department's rate making recommendations regarding those issues?

A. The Board should disallow all of the above market costs of the Contract as

imprudently incurred, in accordance with traditional rate making principles. That amount is estimated by DPS Witness Chernick to be $3,800,000.

In the alternative, if the Board finds that less than all of the above market costs of the Contract were imprudent, the Board should disallow entirely the portion of those above market costs found to be imprudent. The Board should then disallow a portion of the remaining portion of the above market costs as not used and useful.

Q. Please explain the basis for your primary recommendation?

A. DPS Witness Chernick demonstrates clearly why, if Citizens Communications ("Citizens," the "Company") and Franklin Electric Company ("Franklin") had not locked into the Contract in August 1991, the costs the Company would be incurring in the rate year for alternative power sources would be at or near the current market price. Mr. Chernick sponsors an estimate of $45/MWh for the alternative sources that the Company would be facing in the rate year had it acted prudently in and after 1991. In contrast, power purchased from HQ during the rate year will cost an average of $63.5/MWh. The resulting above market costs for the Contract for the instant rate year are $3.8 million.

The Board remarked in its Docket 5983 Order that sound power planning would call for a mix of resources and not just short term market purchases. It might be thought that the prudent cost used in computing a disallowance (or the market price used in computing a used and useful disallowance) should be adjusted upward to reflect that maxim, but I would not do so for two reasons. First, neither Mr. Chernick's prudent portfolio nor the Department's market price projection represent exclusively short term market purchases. Rather, they both represent costs for typical portfolio resources, including where appropriate the full capital and operating cost of new generating plant and the purchase of power under contracts ranging from a year to a decade or more. Thus, they represent, to the extent appropriate, long term costs, not spot prices. Second, the expectation of a diverse portfolio of resource lives and types would apply if the Company

were constructing today a proper least cost plan to replace the Contract over the long term. But that is not the relevant question for determining either damages from the premature lock in or above market costs. What is necessary for computing prudence damages is to consider what would have happened, assuming sound power planning decisions, given the circumstances obtaining between August, 1991, and today.

If Citizens and Franklin had been acting properly over that time period, they would have begun by acquiring the amount of capacity they needed to replace expiring contracts with Hydro Québec. That capacity would have been some combination of spot purchases and contracts ranging from less than one year to perhaps five years. To replace those initial contracts as they expired, and to meet load growth, Citizens would have been positioned to purchase longer-term resources in the buyers' market of the early 1990s. The Company would have, instead of the Contract power, a combination of those longer-term contracts and shorter-term contracts at today's even lower market prices. DPS Witness Chernick explains this evolution in detail.

Q. In Dockets 6107 and 6460, you supported settlements calling for the CVPS and GMP to recover most of their HQ costs. Why have you changed your position?

A. I have not changed my position. Rather, I am applying to the facts of this case the Board’s principles set out in those earlier dockets, so that there is consistency in the basis for rate making, even if the outcome is different. In those settlements and the Orders approving them, the Board made clear two points. First, disallowances in those dockets, comparable to those I recommend here, would be appropriate under the law and traditional rate making, given the facts surrounding the Contract and the premature lock-in. Second, the Board has the discretion to forebear from imposing the full disallowance under certain conditions. Based on the facts of Dockets 6107 and 6460, I concluded that those conditions applied and supported forbearance. Under the facts of this case, I conclude that those necessary conditions are absent and that the Board should not

forebear to impose the full disallowances.

Q. What are those necessary conditions for forbearance?

A. In its Final Order of 1/23/2001 in Docket 6107, the Board explained that:

> The Board's obligation under Vermont law is to establish just and reasonable rates. As this Board has previously ruled, traditional rate-making methodologies may sometimes need to yield to other considerations (such as the need to attract capital) so long as the final result remains fair to ratepayers. Thus, these methodologies:
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> > need not be stringently applied if a greater recovery is "necessary to ensure efficiency and progress in the art and the continued attraction of capital to the enterprise." *Washington Gas Light Co. vs. Baker*, 188 F.2d 11, 19 (1950). Even that exception is limited by the overriding rule that it must not result in unfairness to ratepayers. *Id*.3
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> Applying these principles, we find it necessary to depart from traditional rate making methodologies and to establish rates that, for the good of Vermont ratepayers, will enable GMP to improve its financial viability and to have access to capital markets. In essence, our decision rests upon our judgment that, in light of the record evidence concerning GMP's current financial difficulties, the higher rates in the Third MOU are just and reasonable and not unfair to ratepayers. Expressing the same concept in a more fundamental sense, we do this because we conclude that, for the sake of ratepayers, the financial viability of the Company is so important that we should approve the Third MOU, despite the fact that poor decisions by GMP's prior management are a major cause of the Company's present financial difficulties.

Order at 3; see, *also*, *id.* at 20-26 (GMP's financial situation precarious). Thus, in Docket 6107, the Board specifically found that it was *necessary* to depart from traditional rate making *for the good of Vermont ratepayers*. It was GMP's financial difficulties that made forbearance just and reasonable, so long as it was fair to ratepayers. (Resolution of the comparable CVPS rate case, Docket 6460, turned on precisely the same issues and logic.) Citizens has not demonstrated an inability to access capital or that its ability to provide

safe and reliable service is or would be impaired by the disallowances I recommend.

For example, according to the Company's 2000 Annual Report, Citizens was added to the Standard and Poors 500 in February of 2001. The Company's November 30, 2001, 10-Q, the most recent posted on its web site, shows assets of over $10 billion, equity of nearly $2 billion, and net cash provided by continuing operating activities of about $403 million for the nine months ending September 30, 2001. (The comprehensive cash flow picture in this report is complicated by flows in and out due to investing activities of over $3 billion.) Note 6 to the Financial Statements in that report indicated financings issued by Citizens during the nine months ending September 2001 were:

5 and 10 year notes	$1.726 billion
Equity units (senior debt, plus common stock warrant)	$0.446 billion
Common stock	$0.289 billion
Private placement notes (3 to 30 year terms)	$1.750 billion
Total	$4.211 billion

Item 2(a) of that report indicates that Citizens has approval remaining in its 2001 shelf registration for $0.825 billion. The same item indicates that as of September 30, 2001, the Company had a total available commitment of $0.805 billion available through credit facilities.

Citizens clearly has no current difficulty accessing capital markets. Further, it can be readily concluded that a disallowance of the magnitude I recommend is almost immaterial in proportion to Citizens operating cash flow, assets, equity balance, and demonstrated capacity to raise capital. Given the assets and revenue available to the Company, it is impossible to conclude that forbearance is necessary for efficiency, to

advance the state of the art, or for continued access to capital. Therefore, in this proceeding, the Board cannot and should not allow costs which would normally be disallowed under traditional rate making.

Q. Is it fair to rely on the entire corporation's access to capital in this analysis?

A. Absolutely. In fact, that is just what the Board did in Dockets 5983, 6107, 6120 and 6460. In fact, in GMP's case, the history of losses due to ventures outside its retail electric operations were actually considered in a way that made it easier for GMP to meet the test given above. In any event, for purposes of determining whether departure from traditional rate making is justified, all the resources of the utility are relevant to the facts about access to capital.

Q. But the Vermont Electric Division is a small division of a much larger company, unlike CVPS and GMP. Shouldn't the Board look at VED as if it were a stand-alone utility?

A. No. Citizens has advanced this argument from time to time, but as far as I am aware, the Board has rejected it each time, as did the Vermont Supreme Court.

Given that the Company's costs are imprudent and not used and useful, the question before the Board is whether to forebear from disallowing all imprudent costs and imposing the normal sharing of uneconomic costs. The Board's standard for deciding that question requires a prior finding that such forbearance is both necessary and fair to ratepayers. Logically and according to the precedent in the above cases, the necessity determination inherently and by definition turns on the facts of the Company's real, total financial situation and cannot be based on an examination that ignores that totality. To do so would be fictional and unfair to ratepayers. Thus, where forbearance is the issue, necessity determinations must look at the total enterprise. If VED were financially healthy but Citizens' operations overall were not, so that the Company *in fact* could not provide service under a full disallowance, then there might be a need for forbearance, and limiting

the analysis of need to VED would be unfair to the Company and counterproductive. Conversely, if VED were financially troubled, but the Company as a whole is not, decisions about the need for forbearance must follow the same logic. This was the course followed in the CVPS and GMP cases cited above and is the appropriate policy to follow here.

Previously, in this Docket, the Board denied Citizens' request for a temporary rate increase. Order of 1/16/2002. In that question, as in this one, the focus was on necessity or "a pressing situation." There the Board found that its decision "must be based on findings of the facts as they are," not on "the difficulties that the VED would supposedly be experiencing were it a stand-alone utility." The Board also stated that an award of temporary rates "must be based on the corporate structure that Citizens has chosen, not a corporate structure that might have been." Order at 6.

It is important to note the parallelism between these two questions. Vermont statutes governing rate making procedure allow a certain kind of exception–temporary rate increases–only upon a finding of necessity, which has been construed to require "a pressing situation" and "compelling inference." Order at 3. As the above excerpt from the Board's Order in Docket 6107 explains, the possibility of forbearing from a disallowance that would otherwise follow from traditional rate making is likewise an exception allowed only upon a finding of necessity and, then, only if fair to ratepayers. If the required finding of necessity were allowed to be based on a fiction, the entire framework would provide no assurance of fairness to ratepayers. Such a nonsensical interpretation should be rejected. Rather, the same premise–consideration of the facts of the Company's situation as they are–should be applied.

Q. In various electric rate cases certain municipal utilities, Washington Electric Cooperative ("WEC") and Rochester Electric, the Department supported settlements regarding the Contract that did not call for disallowances. How do you reconcile your position in this

case with those settlements?

A. Those settlements may be distinguished from the current situation in several ways. First, those utilities were in a very different situation regarding access to capital. Unlike Citizens, none of those smaller companies had greater access to capital than GMP and CVPS had. Second, their ratepayers would have been subjected to considerable litigation risk had they been forced to default on the Contract, an outcome that was highly likely in their case and that is not at all likely in the case of Citizens. In addition, WEC, unlike Citizens, did its best to prevent the premature lock-in. And Rochester, unlike Citizens, actually did not have alternatives to the Contract except for its wholesale tariff purchases from CVPS. In summary, the various reasons explained in this paragraph justified a less than 100% disallowance of above market costs from the Contract for those companies, but do not apply to Citizens.

More broadly, Citizens' situation is different from that of the municipal and cooperative utilities. In the case of a municipal or cooperative utility, there is a large degree of congruence between the owners and ratepayers. To the extent that the owners of such a utility are the same as the ratepayers, imprudent and non-used and useful costs are paid by the same persons, whether those costs are or are not disallowed. (There can be case-specific situations where this is not so. *See*, for example, Final Order in Docket 5810/11/12.) Hence, forbearance would treat Citizens' owners *better* than the owners of municipal and cooperative utilities participating in the Contract. This is explained in the following exchange at a technical hearing in Docket 6460.

> CHAIRMAN DWORKIN: When I say "publicly owned," I mean municipally owned. Let's look at the cooperatives, which are member owned. When they pay their rates, if there's no disallowance, isn't it true that the owners wind up through their rates paying a hundred percent of the imprudent costs?
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> MR. BOYLE: They pay a hundred percent of the costs, that's correct.
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> CHAIRMAN DWORKIN: Both prudent and the imprudent

ones; right?

MR. BOYLE: Of the total costs, whatever they are.

Tr. Docket 6460 5/15/01at 108:8 to 108:20.

Q. Please summarize your recommendation.

A. I recommend that the Board apply its traditional rate making principles and disallow all the above market costs of the Contract for the rate year as imprudent. Alternatively, if the Board finds that less than all of the above market costs of the Contract were imprudent, the Board should disallow entirely the portion of those above market costs found to be imprudent. The Board should then disallow a portion of the remaining portion of the above market costs as not used and useful. The Board should find that forbearance is not warranted, but should impose the recommended disallowance in full.

Q. Does that complete your testimony at this time?

A. Yes.